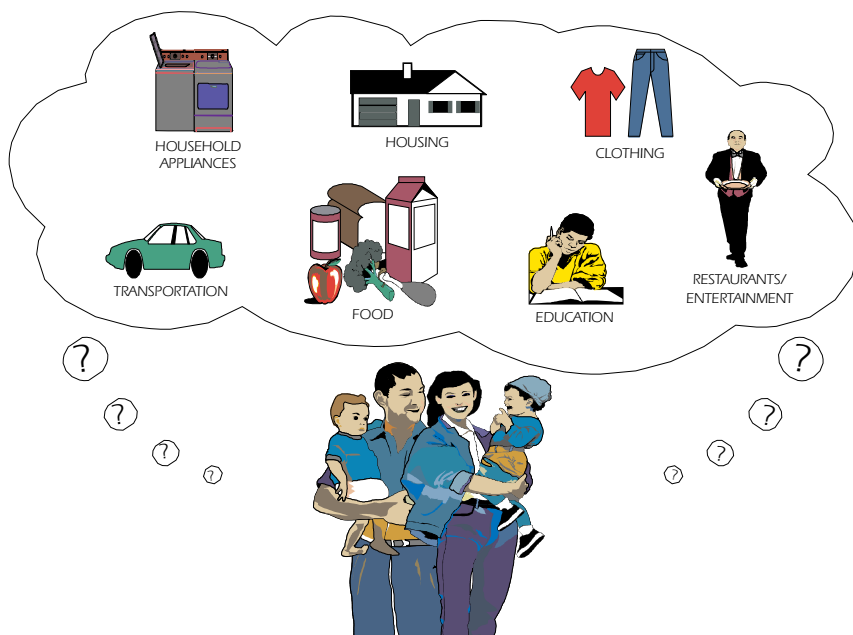


2. Where the Money Comes From—and Where it Goes

In a typical American household, a father and mother might sit around the kitchen table to review the family budget. They might discuss how much they expect to earn each year, how much they can spend on food, shelter, clothing, transportation, and perhaps a vacation, and how much they might be able to save for their future needs.

If they do not have enough money to make ends meet, they might discuss how they can spend less, such as by cutting back on restaurants, movies, or other entertainment. They also might consider whether to try to earn more by working more hours or taking another job. If they expect their shortfall to be temporary, they might try to borrow.

Chart 2-1. Family Budgeting



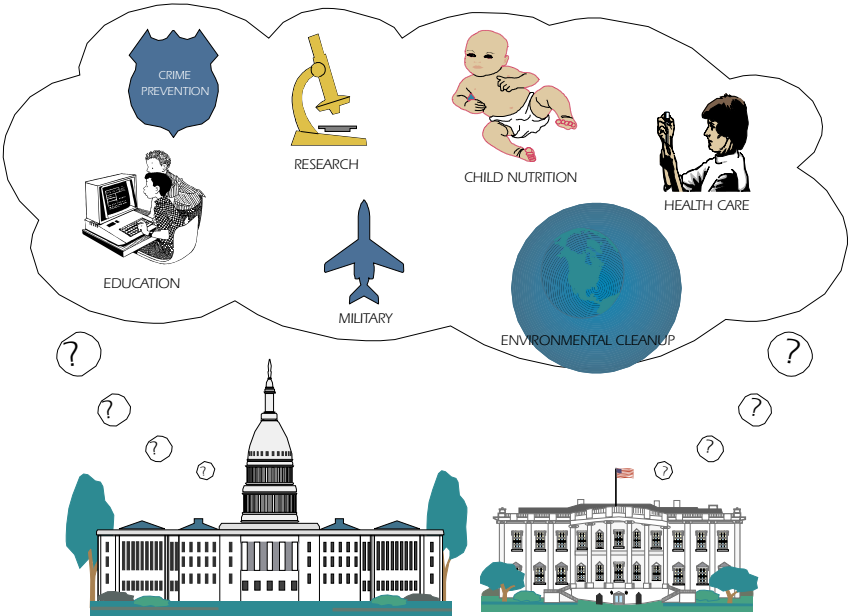
SOURCES: CASH AND CREDIT

Generally speaking, the Federal Government plans its budget much like families do. The President and Congress determine how much money they expect the Government to receive in each of the next several years, where it will come from, and how much to spend to reach their goals—goals for national defense, foreign affairs, social insurance for the elderly, health insurance for the elderly and poor, law enforcement, education, transportation, science and technology, and others.

They decide how much spending they will finance through taxes and how much through borrowing. They debate how to use the budget to help the economy grow, or to redistribute income. And, especially lately, they debate how to reduce spending in order to eliminate the deficit and balance the budget.

In this chapter, we will discuss these decisions in some detail—that is, how the Government raises revenues and where it spends money.

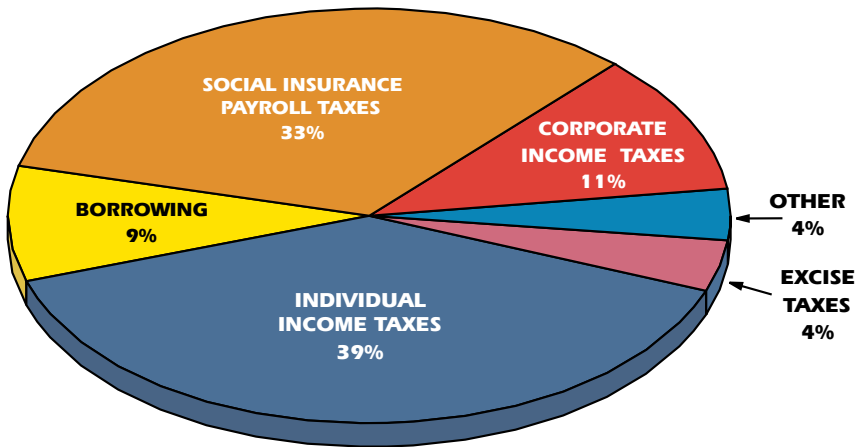
Chart 2-2. National Budgeting



SOURCES: TAXES AND BORROWING

Revenues

**Chart 2-3. The Federal Government Dollar—
Where It Comes From**



The money that the Federal Government uses to pay its bills—its revenues—comes mostly from taxes. In recent years, revenues have been lower than spending, and the Government has borrowed to finance the difference between revenues and spending—that is, the deficit.

Revenues come from these sources:

- Individual income taxes will raise an estimated \$645 billion in 1997, equal to about 8 percent of GDP—about the same percent as in each of the last 40 years.
- Social insurance payroll taxes—the fastest growing category of Federal revenues—include Social Security taxes, Medicare taxes, unemployment insurance taxes, and Federal employee retirement payments. This category has grown from two percent of GDP in 1955 to seven percent in 1997.
- Corporate income taxes, which will raise an estimated \$185 billion in 1997, have shrunk steadily as a percent of GDP, from 4.6 percent in 1955 to 2.2 percent today.

Table 2-1. Revenues By Source—Summary

(In billions of dollars)

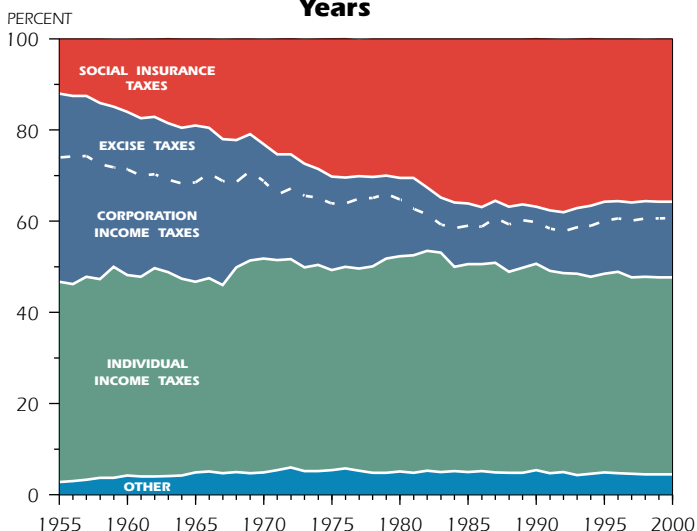
Source	1995 Actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
Individual income taxes	590	631	645	683	714	749	790	835
Corporate income taxes	157	167	185	202	213	225	237	246
Payroll taxes	484	508	536	561	589	619	647	679
Excise taxes	57	54	60	60	62	63	64	66
Estate and gift taxes	15	16	17	18	19	21	22	24
Customs duties	19	19	20	21	21	22	22	24
Miscellaneous receipts	32	32	32	33	34	35	37	38
Total revenues	1,355	1,427	1,495	1,578	1,653	1,734	1,820	1,912

Notes: The revenues listed in this table do not include revenues from the Government's business-like activities—e.g., the sale of electricity and fees to national parks. The Government counts these revenues on the spending side of the budget, deducting them from other spending to calculate its outlays for the year.

Numbers may not add to the totals due to rounding.

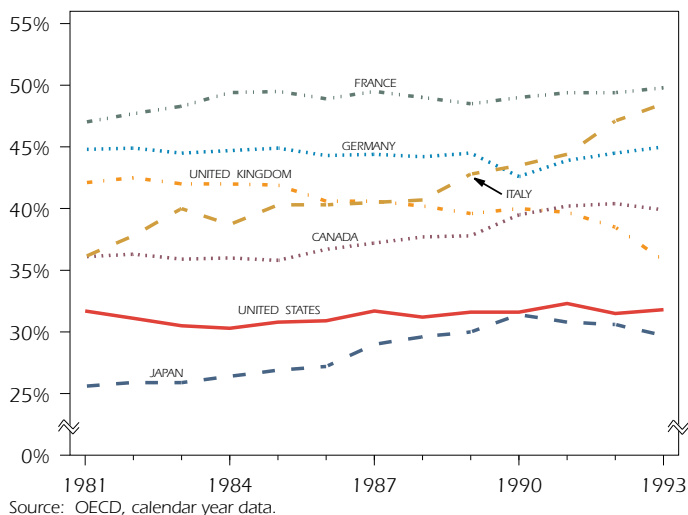
- Excise taxes apply to various products, including alcohol, tobacco, transportation fuels, and telephone services. The Government earmarks some of these taxes to support certain activities—including highways, airports and airways, and the cleanup of hazardous substances—and deposits others in the general fund.
- The Government also collects miscellaneous revenues—e.g., customs duties, Federal Reserve earnings, fines, penalties, and forfeitures.

Chart 2-4. Composition of Revenues Over the Last 40 Years



Between 1960 and 1995, payroll taxes have increased substantially as a percent of GDP, and corporate income taxes have declined, but individual income taxes have remained roughly constant. These trends are not expected to change over the next five years.

Chart 2-5. Revenues as a Percent of GDP—Comparison With Other Countries



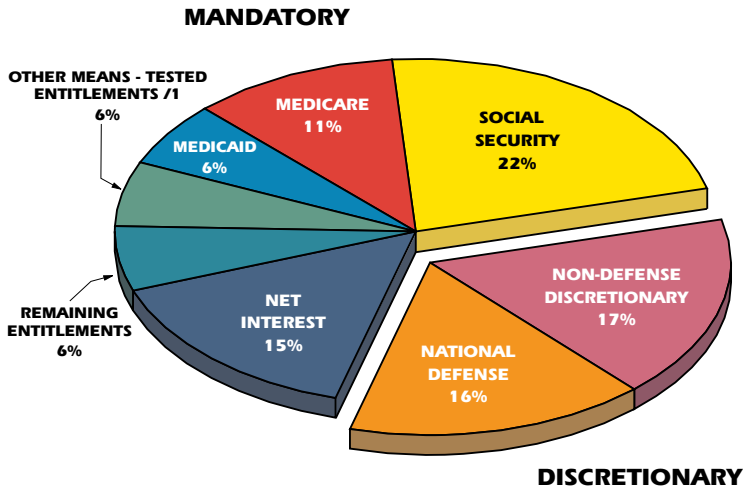
The United States and Japan have the lowest revenues as a percent of GDP of the seven countries listed above.

Spending

As we have said, the Federal Government will spend over \$1.6 trillion¹ in 1997, which we divided into eight large categories as shown in Chart 2-6.

- The largest Federal program is Social Security, which provides monthly benefits to more than 43 million retired and disabled workers, their dependents, and survivors. It accounts for 22 percent of all Federal spending.
- Medicare, which provides health care coverage for over 37 million elderly Americans and people with disabilities, consists of Part A (hospital insurance) and Part B (insurance for physician costs and other services). Since its birth in 1965, Medicare has accounted for an ever-growing share of spending. In 1997, it will comprise 11 percent.

**Chart 2-6. The Federal Government Dollar—
Where It Goes**



Note: Numbers do not add due to rounding.

¹ Means-tested entitlements are those for which eligibility is abased on income. The Medicaid program is also a means-tested entitlement

¹ In calculating Federal spending, the Government deducts collections (or revenues) generated by the Government's business-like activities, such as fees to national parks. These collections will total an estimated \$190 billion in 1997. Without them, spending would total an estimated \$1.8 trillion in 1997, not \$1.6 trillion.

- Medicaid provides health care services to over 36 million Americans, including the poor, people with disabilities, and senior citizens in nursing homes. Unlike Medicare, the Federal Government shares the costs of Medicaid with the States, paying between 50 and 83 percent of the total (depending on each State's requirements). Federal and State costs are growing rapidly. Medicaid accounts for six percent of the Federal budget.
- Other means-tested entitlements provide benefits to people and families with incomes below certain minimum levels that vary from program to program. The major means-tested entitlements are Food Stamps and food aid to Puerto Rico, Aid to Families with Dependent Children, Supplemental Security Income, Child Nutrition, the Earned Income Tax Credit, and veterans' pensions. This category will account for an estimated six percent of the budget in 1997.
- The remaining entitlements, which mainly consist of Federal retirement and insurance programs and payments to farmers, comprise six percent of the budget.
- National defense discretionary spending will total an estimated \$259 billion in 1997, comprising 16 percent of the budget and 3.3 percent of GDP.
- Non-defense discretionary spending—a wide array of programs that include education, training, science, technology, housing, transportation, and foreign aid—has shrunk as a share of the budget from 23 percent in 1966 to an estimated 17 percent in 1997.
- Interest payments, primarily the result of previous budget deficits, averaged seven percent of Federal spending in the 1960s and 1970s. But, due to the large budget deficits that began in the 1980s, that share quickly doubled to 15 percent, where it stands today.

Table 2-2. Spending Summary

(Outlays, in billions of dollars)

Category	1995 Actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
Discretionary:								
National Defense	274	266	259	256	257	264	267	276
International	20	20	20	19	19	18	18	19
Domestic	252	255	263	264	260	255	264	278
Subtotal, discretionary	546	541	542	539	536	537	548	573
Mandatory:								
Programmatic:								
Social Security	333	348	365	383	402	421	442	464
Medicare	157	175	187	202	216	228	246	264
Medicaid	89	95	106	111	117	122	129	133
Means-tested entitlements (except Medicaid)	92	97	104	109	114	121	121	129
Other	114	118	134	138	142	147	147	151
Subtotal, programmatic	786	832	896	943	990	1,040	1,084	1,141
Undistributed offsetting receipts	-44	-42	-41	-42	-43	-46	-48	-69
Subtotal, mandatory	741	790	855	901	947	955	1,036	1,072
Net interest	232	241	238	236	235	230	227	223
Subtotal, mandatory and net interest	973	1,031	1,093	1,137	1,181	1,225	1,263	1,295
Total	1,519	1,572	1,635	1,676	1,717	1,761	1,812	1,868

Note: Numbers may not add to the totals due to rounding.

Table 2-3. Spending by Function

(Outlays, in billions of dollars)

Function	1995 Actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
National defense:								
Department of Defense-Military	259	254	247	244	246	254	257	265
Other	13	11	11	11	10	9	9	11
Total, National defense.	272	266	259	255	256	263	266	275
International affairs	16	15	15	14	14	13	14	15
General science, space, and technology	17	17	17	17	16	15	15	17
Energy	5	3	2	2	2	1	2	*
Natural resources and environment. . .	22	22	22	21	21	20	21	22
Agriculture.	10	8	8	9	9	8	7	7
Commerce and housing credit	-14	-11	6	6	7	7	5	5
Transportation	39	40	39	39	37	35	34	35
Community and regional development	11	13	12	10	9	8	8	8
Education, training, employment, and social services	54	54	54	54	56	57	59	62
Health.	115	121	135	141	147	152	156	162
Medicare	160	178	190	205	218	231	248	267
Income security	220	228	237	245	253	264	269	282
Social Security.	336	351	368	386	405	424	445	467
Veterans benefits and services	38	38	40	39	37	37	36	40
Administration of justice.	16	19	22	24	25	26	26	25
General government	14	14	15	14	14	14	15	15
Net interest	232	241	238	236	235	230	227	223
Allowances	-*	-*	-*	-*	-*	5	9
Undistributed offsetting receipts	-44	-42	-41	-42	-43	-46	-48	-69
Total.	1,519	1,572	1,635	1,676	1,717	1,761	1,812	1,868

* \$500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.

Numbers may not add to the totals due to rounding.

Table 2-4. Spending by Agency

(Outlays, in billions of dollars)

Function	1995 Actual	Estimate						
		1996	1997	1998	1999	2000	2001	2002
Legislative Branch	3	3	3	3	3	3	3	3
The Judiciary	3	3	4	4	4	4	4	4
Executive Office of the President	*	*	*	*	*	*	*	*
Funds Appropriated to the President	11	10	10	10	10	10	9	10
Agriculture	57	55	56	58	59	59	61	63
Commerce	3	4	4	4	5	6	4	4
Defense—Military	260	254	247	244	246	254	257	265
Defense—Civil	32	32	33	34	35	36	37	38
Education	31	30	30	29	30	31	32	33
Energy	18	15	15	14	13	12	12	12
Health and Human Services	303	327	354	378	397	416	439	465
Housing and Urban Development	29	26	32	33	33	31	30	30
Interior	7	7	7	7	7	7	7	7
Justice	11	13	16	18	19	20	20	19
Labor	32	34	35	36	37	38	40	41
State	5	6	6	5	5	5	5	5
Transportation	39	39	38	38	36	34	33	35
Treasury	349	365	369	370	374	376	377	381
Veterans Affairs	38	38	40	39	37	37	36	40
Environmental Protection Agency	6	6	6	7	7	7	7	7
General Services Administration	1	*	1	1	*	*	*	*
National Aeronautics and Space Administration	13	14	14	14	13	12	12	13
Office of Personnel Management	41	42	45	47	49	51	54	57
Small Business Administration	1	1	*	*	*	*	*	1
Social Security Administration	362	377	398	418	438	462	480	506
Other Independent Agencies	2	9	21	20	20	19	19	20
Allowances		-1	-5	-7	-6	-7	-2	*
Undistributed offsetting receipts	-138	-140	-143	-148	-153	-161	-166	-192
Total	1,519	1,572	1,635	1,676	1,717	1,761	1,812	1,868

* \$500 million or less.

Notes: Spending that is shown as a minus means that receipts exceed outlays.

Numbers may not add to the totals due to rounding.

“On” and “Off” Budget

From time to time, you may hear about programs that are “off-budget,” meaning that the Government categorizes them separately from other programs.

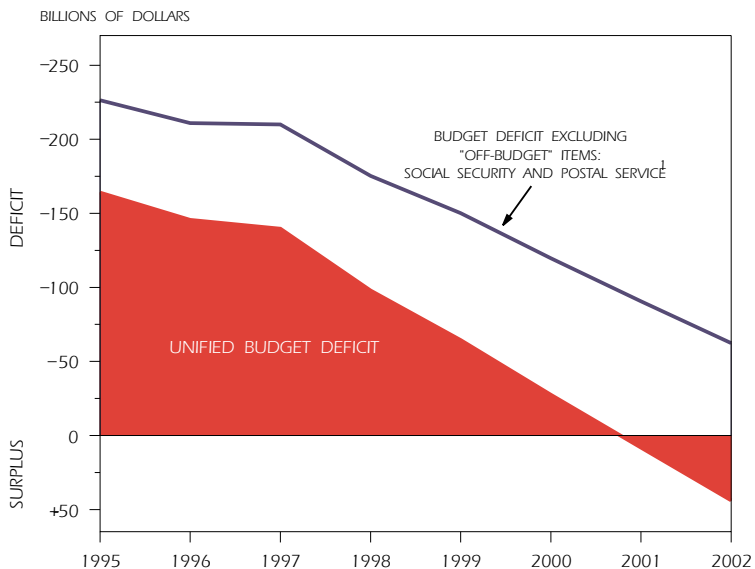
Specifically, the law requires that the spending and revenues of two Federal programs, Social Security and the Postal Service, be excluded from the budget totals—that is, categorized as “off-budget.” Therefore, the budget displays “on-budget,” “off-budget,” and “unified budget” totals to satisfy this legal requirement.

The unified budget is the most useful display of the Government’s finances; it is vital in calculating how much the Government has to borrow.

The “off-budget” category is designed to give special status to certain programs. Over the years, the Government has placed numerous programs “off-budget,” then returned them to the unified budget. But the mere listing of programs as “off-budget” does not, by itself, protect them from the budget process—e.g., Administration and congressional review, possible cuts, and hiring and procurement rules.

Chart 2-7 illustrates the relationship between on- and off-budget items, and the unified budget.

Chart 2-7. On- and Off-Budget Deficit Projections



¹ By law, the Social Security trust funds and the Postal Service are “off-budget.”